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SUBJECT: FDI IN MEXICO: 2007 GREAT, WHAT ABOUT 2008?

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¶1. Summary: FDI inflows to Mexico for the first three quarters of 2007 topped USD 18 billion and are expected to reach USD 23 billion for CY2007. At the same time, Mexico fell three slots in investment confidence as other countries surpassed it in investment attractiveness. CY2008 will likely see FDI inflows drop to under USD 20 billion on U.S. economy woes, as well as changes to the Federal Foreign Investment Law. The consensus among economic analysts is that, to ensure that FDI levels maintain their growth, the Calderon Administration should continue its reform push and look to increase investment from non-U.S. sources. Mexico is currently at an important point in time as actions, or lack thereof, by the GOM could result in steady year-over-year FDI growth or continued stagnation for the near future.

2007: Record Year

¶2. For the period January to September 2007, FDI equaled USD 18.4 billion, an increase of 30.3% over the same period in 2006 (USD 14.1 billion). This is the second highest amount recorded, surpassed only in 2001 when CitiBank acquired Banamex for 12.5 billion dollars, skewing the FDI figures for that year. Of this amount, 39.7% (USD 7.3 billion) went towards new investments, 21.7% (USD 4 billion) towards reinvestment, and 38.6% (USD 7.1 billion) towards transfers between company accounts. The manufacturing sector continued to be the primary beneficiary of FDI, receiving 51.1% while the service sector received 31.4%. The U.S. was the source country for 50.4% of FDI followed by the Netherlands (12.6%), Spain (9.8%), and France (9.3%).

¶3. Undersecretary for Regulation, Foreign Direct Investment and International Commercial Practices, Carlos Arce, continues to predict that total FDI for 2007 will top USD 23 billion (reftel), although he said preliminary figures will not be available until the third week of February. Secretary of Economy Sojo attributes the strong increase in FDI to international investors' favorable expectations for the Mexican economy and says that the flows confirm that Mexico is one of the most attractive destinations for international investment flows, especially in Latin America.

¶4. Conversely, Mexico's rank in A.T. Kearney's Foreign Direct Investment Confidence Index was recently lowered from 16 to 19. According to company officials, the new rank reflects measures other countries have taken to increase their attractiveness to investors rather than Mexican shortcomings. Mexico is also more strongly affected by volatility in the U.S. economy and the weak dollar, both which factor heavily in international investors' decision making processes. Additionally, while Mexico ranks 10th in investor confidence for North American investors, it fails to attract Asian and European investors, making it even more vulnerable to a U.S.

recession. By comparison, Brazil ranked 7th among North American investors, 4th among Asian investors, and 8th among European investors.

2008: Strong, but suffering from U.S. economic weakness
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¶5. FDI inflows for 2008 will be strong, but will not reach 2007 levels according to Secretary of Economy Eduardo Sojo who announced that FDI in 2008 will only reach USD 20 million as Mexico feels the effects of the U.S. deceleration. Total FDI inflows of USD 20 billion would make 2008 the 4th strongest of the past 10 years.

¶6. In 2008, Economy Secretariat (SE) officials will also continue their push to update the Federal Foreign Investment Law. The planned amendments increase sanctions on companies that fail to report their investments on time. Currently, companies report investments up to 3 years after the deadline required by law, meaning that the SE has to estimate FDI figures. For example, the total amount listed above for the first three quarters of 2007 includes an estimate of USD 3.3 billion in new investment that has not yet been reported. Salvador Carrerus Lemus, Director of Quality and Statistics for the General Directorate of Foreign Investment explained that, between March 31, 2007 and September 30, 2007, an additional USD 1 billion in FDI for 2006 was reported even though reports for the final trimester of 2006 were due before February 7,
¶2007. He further estimates an additional USD 2.3 billion to be reported over the next 2 years from investments that SE is aware have already taken place. Final figures change every quarter, making it difficult for officials to analyze trends and provide timely policy recommendations in a timely fashion. Additionally, requiring companies to report investments quickly will increase transparency as companies will be less able to modify numbers and final numbers will be less affected by possible errors in GOM

estimates.

Comment

¶7. The passage of the fiscal reform package and the government's receptiveness to complaints by the business community showed investors that the GOM is committed to strengthening Mexico's investment climate. However, continued weakness in the U.S. economy will reduce FDI coming from U.S. sources for at least the next 12-24 months while overall growth could be effected for an even longer period.

¶8. While Mexico has a growing economy, a stable democratic political environment, and a strategic location adjacent to the U.S. and both the Pacific and Atlantic oceans, it is nonetheless in a delicate position with respect to foreign investment. Other developing countries are stepping up promotion efforts to lure investors. Mexico no longer has a monopolistic advantage when it comes to cheap semi-skilled labor (in fact, this might be a disadvantage now compared to India and China). Delays due to inefficiency, lack of infrastructure, and increase border security cut into the benefits of Mexico's proximity to the U.S. Mexico will have to become more competitive, at a quicker pace, in order to maintain its spot.

¶9. Mexico will need to continue its reform push. Labor reform will allow companies to find and hire the most efficient workers will education reform will prepare the next generation and increase the pot of skilled workers to chose from. Telecommunication and energy reform would open up the Mexican economy to billion of dollars in investment, while helping to lower prices for telecommunication consumers and modernize and develop the energy sector. While political realities mean that meaningful reform in these areas will be nearly impossible over the next year, even small steps toward reform will shore up investor confidence and draw additional FDI inflows.

¶10. Additionally, Mexico needs to also expand its investment base beyond the U.S. President Calderon's administration understands the

need to branch out and "put more Mexico in the world and more of the world in Mexico", if nothing more than to decrease the country's overwhelming dependence on the U.S. A major responsibility of the GOM agency ProMexico, created in July 2007, will be to promote investment from high potential countries such as Spain, Great Britain, Japan, and Germany, from which Mexico currently captures slightly more than 1% of a combined 230 billion dollars in global FDI.

Conclusion

¶11. The immediate future of FDI in Mexico depends on many factors, both internal and international. While the GOM cannot change international economic realities, it can take concrete steps to increase the attractiveness of Mexico vis-a-vis the rest of the world and draw a larger share of investment from a growing global pot.

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